



# Highlights and Analysis of the Governor's May Revision of the 2005-06 Budget

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## Overview of the 2005 May Revision

**Improving Upon the Governor's Budget.** The May Revision improves upon the Governor's Budget in many ways, and it contains a number of features that are consistent with the priorities of Senate Republicans:

- **Eliminates Reliance Upon Economic Recovery Bond (ERB) Funding in 2005-06:** Due to a significant increase in one-time revenue, the Governor's Budget no longer proposes to utilize \$1.683 billion in Economic Recovery Bond (ERB) funding in 2005-06, thus it retains the bond capacity in anticipation of future need.
- **Fully Funds Proposition 42 Transfer.** The May Revision provides \$1.313 billion for badly needed transportation infrastructure investment.
- **Provides Partial Funding for the Vehicle License Fee (VLF) Gap Loan Repayment:** The May Revision prepays half of the funding owed to local governments (about \$593 million) for VLF fees they did not receive in 2003-04, and that come due in 2006-07.
- **Provides California Community College (CCC) equalization funding:** The May Revision proposes to provide \$40 million in Proposition 98 General Fund for efforts to equalize CCC funding disparities.
- **Restores Senior Citizen's Property Tax Assistance Program Funding:** The May Revision restores full funding to the property tax assistance and renter's tax assistance programs (\$136.6 million).

***With these and other key proposals contained in the Governor's Budget, the May Revision continues to lower the debt without resorting to higher taxes.***

**The Need for Budget Reform Continues.** While some of the steps mentioned above temporarily assist in creating less need for borrowing, and work to temporarily reduce pressure on existing resources, they do not remedy the structural budget problems facing California. The state continues to spend more each year than it takes in, and it still carries an operating deficit of approximately \$4 billion that has yet to be addressed. Funding in many state agencies is growing faster than revenues, placing ever-increasing pressure on the General Fund. Without meaningful structural reform, the annual imbalance will likely grow, particularly if the economy should take a turn for the worse.

Beyond the rhetoric, the case for reform is compelling. Overall General Fund expenditures are growing at a considerable clip year over year. A case in point: \$78.9 billion in total General Fund expenditures were authorized pursuant to the Budget Act of 2004, however the revised estimate of General Fund expenditures for that same year in the May Revision is now \$82 billion (a \$3.1 billion increase). Further, ***the 2005-06 budget contained in the May Revision proposes to spend \$88.5 billion, which is 12.25 percent more than authorized in the 2004 Budget Act.*** Such year-over-year increases are difficult to sustain even in times of increased revenue, and will continue to hamper the state's ability to live within its means if left unchecked.

**Changes in Overall General Fund Expenditures:** The May Revision proposes to spend \$88.5 billion in General Fund in 2005-06, up from the revised \$82 billion in 2004-05, and \$2.8 billion more than the level proposed for 2005-06 in the Governor's Budget (Table 1). The largest increase in expenditures is in Business, Transportation and Housing, where \$1.3 billion is reflected as a result of the Proposition 42 transfer mentioned above. The next largest increase is found in General Government, where the total includes funding for the partial payment of the VLF gap loan repayment mentioned above.

**Table 1**

<b>Governor's January 10 Budget vs. May Revision 2005-06 Expenditures (Dollars in millions)</b>				
	<b>Governor's Budget</b>	<b>May Revise</b>	<b>Difference</b>	<b>% Change</b>
<b>NON-PROPOSITION 98:</b>				
Governor's Office	\$18.3	\$18.3	\$0	0.0%
Remaining Executive	759.8	839.0	79.2	10.4%
Legislature	309.9	309.9	0	0.0%
Judicial	1,928.2	1,952.6	24.4	1.3%
State and Consumer Services	563.4	575.9	12.5	2.2%
Business, Transportation and Housing	380.3	1,702.1	1,321.8	347.6%
Resources/Environmental Protection	1,338.7	1,430.0	91.3	6.8%
Health and Human Services	26,689.2	26,815.7	126.5	0.5%
Youth and Adult Correctional	6,979.7	7,213.5	233.8	3.3%
Non-Proposition 98 Education	8,589.3	8,624.0	34.7	0.4%
STRS Contribution	581.4	581.4	0	0.0%
Labor and Workforce Development	87.2	92.3	5.1	5.8%
General Government	980.1	1,554.8	574.7	58.6%
<b>Total -- Non-Proposition 98</b>	<b>\$49,205.5</b>	<b>\$51,709.5</b>	<b>\$2,504.0</b>	<b>5.1%</b>
<b>PROPOSITION 98:</b>	<b>\$36,532.3</b>	<b>\$36,815.8</b>	<b>\$283.5</b>	<b>0.8%</b>
<b>TOTAL -- ALL EXPENDITURES</b>	<b>\$85,737.8</b>	<b>\$88,525.3</b>	<b>\$2,787.5</b>	<b>3.3%</b>

## General Fund Revenue Estimates

**General Fund Revenue Forecast.** General Fund revenues are expected to be above the Governor's January Budget by \$2.8 billion in 2004-05 and above the Governor's Budget by \$1.1 billion in 2005-06. Strong April Personal Income Tax payments and Corporate Tax growth account for the bulk of this growth. The Administration also indicates the state will receive \$3.9 billion in prior-year adjustments, resulting from amnesty claims and protected payments (see below), as well as other minor adjustments (approximately \$200 million.)

**Amnesty.** The Administration reports that \$815 million has been paid or will be paid to the state through the amnesty program and \$3.3 billion was deposited in protective claims for a total of \$4.1 billion. Of this amount, \$3.7 billion is being treated for accounting purposes as "prior-year adjustments" and \$400 million is booked as new revenue since the January budget. It is estimated that 95 percent of the revenue from protective payments will have to be repaid over the next three years.

**Personal Income Tax:** The personal income tax forecast has been increased by \$2.4 billion in 2004-05 to \$41.9 billion and by \$319 million in 2005-06 to \$43.2 billion. General Fund payments received in April and the first days of May were \$1.2 billion over the January forecast, which suggests that taxable income was stronger than expected for the year. The 2003 tax data indicate higher income and liability growth for taxpayers with gross income over \$100,000. Capital gains income growth in 2004 was 32.5 percent; which is on top of the 34-percent growth in 2003. The Administration believes that capital gains will still continue to grow, but at a much slower pace in 2005. In addition, new accounting rules that require companies to expense stock options will result in a loss of revenue in future years.

**Sales & Use Tax:** The sales and use tax forecast has been decreased by \$75 million in the current year to \$25.1 billion, and increased by \$4 million in the budget year to \$27 billion. Included in this forecast is an increase in General Fund revenue of \$165 million in 2005-06 as a result of transfers of excess sales tax revenue on gasoline, which would otherwise be designated as Public Transportation Account spillover.

**Corporation Tax:** The corporation tax forecast has increased by approximately \$343 million in 2005-06 to \$9 billion, and increased by approximately \$852 million in 2005-06, to \$9.9 billion. This improvement is attributable to positive corporate profits in 2004 after three years of flat or negative growth.

The difference between the January forecast and the May Revision is summarized in Table 2 below.

Table 2

<b>General Fund Revenues</b> (Dollars in millions)			
<b><u>Fiscal Year 2003-04</u></b>	<b><u>Jan 10 Budget</u></b>	<b><u>May Revision*</u></b>	<b><u>Difference</u></b>
Personal Income Tax	\$36,399	\$36,399	\$0
Sales & Use Tax	23,847	23,847	0
Corporation Tax	6,926	6,926	0
Other Revenues and Transfers	7,590	7,590	0
<b>Total</b>	<b>\$74,762</b>	<b>\$74,762</b>	<b>\$0</b>
<b><u>Fiscal Year 2004-05</u></b>			
Personal Income Tax	\$39,527	\$41,894	\$2,367
Sales & Use Tax	25,168	25,093	-75
Corporation Tax**	8,678	9,021	343
Other Revenues and Transfers	4,846	4,947	101
<b>Total</b>	<b>\$78,219</b>	<b>\$80,955</b>	<b>\$2,736</b>
<i>Change from 2003-04</i>	<i>\$3,457</i>	<i>\$6,193</i>	
<i>% change from 2003-04</i>	<i>4.62%</i>	<i>8.28%</i>	
<b><u>Fiscal Year 2005-06</u></b>			
Personal Income Tax	\$42,895	\$43,214	\$319
Sales & Use Tax	26,947	26,951	4
Corporation Tax**	9,015	9,867	852
Other Revenues and Transfers	4,915	4,885	-30
<b>Total</b>	<b>\$83,772</b>	<b>\$84,917</b>	<b>\$1,145</b>
<i>Change from 2004-05</i>	<i>\$5,553</i>	<i>\$3,962</i>	
<i>% change from 2004-05</i>	<i>7.10%</i>	<i>4.89%</i>	

\*These figures exclude \$3.9 billion in prior year adjustments. The bulk of the adjustments are protective claims as a result of the amnesty program.

\*\* The Corporate tax figures are an approximation from caucus staff, since the Administration included some amnesty related liabilities in their corporate revenue totals.

## Education

**K-12 Education.** While California's teachers are the highest-paid in the nation, with average salaries exceeding \$58,000 per year, its student test scores are among the lowest. The Governor's May proposal for education is substantially similar to his January proposal, continuing its focus on student achievement.

**Current Year Proposition 98 Guarantee Remains Suspended.** Current year revenues have increased significantly over final Budget Act estimates, pushing the current year guarantee up by about \$1.8 billion since last August. However, because the guarantee is currently suspended, that increase has no effect on 2004-05 appropriations, which continue at about \$47 billion, or about \$3.8 billion under the Test 2 level.

**Proposition 98 Overappropriated in 2005-06.** The 2005-06 Proposition 98 minimum guarantee has fallen since January from \$50 billion to \$49.5 billion. However, rather than reduce expenditures to conform to the guarantee, the Governor proposes leaving expenditures at the January level, thereby creating an overappropriation of about \$500 million, over \$216 million above the Test 2 level. Year-over-year funding will increase by about \$3 billion (6.45%) from 2004-05 to 2005-06. Table 3 below details the changes in Proposition 98 between the January Governor's Budget and the May Revision, as well as proposed K-12 per-pupil expenditures, both from Proposition 98 and from all fund sources (including federal funds, lottery funds, etc).

In addition to the \$3 billion increase in base funding, the May Revision also proposes to increase expenditures from the Proposition 98 Reversion Account by about \$36 million and to spend another \$252 million to extinguish a portion of the state's \$1.2 billion Proposition 98 "settle-up" obligation by funding a variety of programs described later in this section.

**Table 3**

<b>2005-06 Proposition 98 Funding</b>			
(Dollars in thousands)	<b>Jan 10 Budget</b>	<b>May Revision</b>	<b>Difference</b>
<b>Minimum guarantee</b>	\$49,967,620	\$49,458,334	-\$509,286
<b>General Fund</b>	\$36,532,334	\$36,815,833	+\$283,499
<b>Local property taxes</b>	<u>\$13,435,286</u>	<u>\$13,151,787</u>	<u>-\$283,499</u>
<b>Proposed appropriation</b>	\$49,967,620	\$49,967,620	\$0 a/
<b>Minimum guarantee</b>	\$49,967,620	\$49,458,334	-\$509,286
(Actual Dollars)			
<b>K-12 P98 per-pupil funding</b>	\$7,034	\$7,402	+\$368
<b>K-12 total per-pupil funding</b>	\$10,084	\$10,201	+\$117
<b>K-12 average daily attendance</b>	6,063,491	6,031,404	-32,087

**Growth Falls, COLA Rises.** The May Revision provides full funding for anticipated K-12 growth (0.69%) and COLA (4.23%). These unrestricted funds (over \$1.8 billion) may be used by school districts for whatever purposes they deem necessary or desirable.

**Categorical Flexibility Expanded.** The May Revision proposes to expand local authority to shift funding between programs. Specifically, the flexibility currently included in budget Control Section 12.40 would be expanded to allow up to 50% (instead of the current 10%) of any program listed in that section to be transferred to any other listed program, except that the receiving program could not grow beyond 150% (currently 115%) of its base appropriation. This same expanded flexibility would apply to four of the block grants created in last year's AB 825 (School Safety Block Grant, Professional Development Block Grant, Targeted Instructional Improvement Block Grant, and School and Library Improvement Block Grant), which are currently limited to "15% out, 20% in."

**Special Education Mental Health Mandate Repealed (AB 3632).** In January, the Governor proposed, for the second year, to suspend the existing state mandate for counties to provide mental health services for special education students, as schools are already federally mandated to provide these services. The May Revision changes that proposal to an outright *repeal* of the mandate. The proposed budget continues to provide \$100 million in combined federal and state funding which can be used by local educational agencies in support of these services, and adds \$90 million to fund counties' prior mandate claims. Counties will still be free to provide such services, but they will no longer be mandated by the state to do so.

**Charter School Facilities Funding Grows.** The Governor proposes to schedule \$19.5 million in new federal grant funds (two years' worth) and \$9 million in state matching funds to support the lease or construction of charter school facilities. The program will be administered by the California School Finance Authority within the State Treasurer's Office.

**Teachers' Pension Shift Still on the Table.** The Governor continues his January proposal to withdraw about \$470 million in state contributions toward teachers' retirements. Districts could either pay these costs directly (effectively reducing the Proposition 98 growth rate from 6.45% to 5.45%), or could bargain with their teachers' unions to assume part or all of these costs.

**Settle-Up Obligation Reduced.** The May Revision also proposes to spend about \$252 million in Proposition 98 "settle-up" (mostly associated with 1995-96 and 1996-97) for a variety of programs:

- \$57.5 million for supplemental instruction targeted toward students at risk of failing the High School Exit Examination
- \$52.4 million to expand class size reduction by one grade for decile 1-3 schools (those whose students' test results are the lowest)
- \$49.5 million for teacher recognition pay for teachers in decile 1-3 schools (bonuses, staff development, mentoring, etc).
- \$30 million to expand the Beginning Teacher Support and Assessment (BTSA) to teachers beyond their first and second years.
- \$30 million to establish a pilot career technical (vocational ed) program to allow career exploration coursework in the 7<sup>th</sup> and 8<sup>th</sup> grades.
- \$18.2 million to increase the reimbursement rate for school breakfasts by 10 cents so as to ensure that schools offer more fresh fruit in these meals (\$17.2 million) and provide start-up grants for schools that do not currently offer a breakfast program (\$1 million).
- \$10 million for equipment and infrastructure to allow Community College districts to increase nursing program enrollment by 1,800 slots.
- \$1.6 million to encourage high schools to establish smaller learning environments ("schools within a school")
- \$500,000 to reimburse the state's 50,000 high school coaches for training on the identification, risks, and effect of performance enhancing drugs.

Although settle-up funding is one-time in nature, some of these proposed uses are not. The Administration intends to evaluate the implementation of the various programs next year to determine the appropriate focus and magnitude of funding in subsequent budgets.



**Proposed Child Care Reforms Unchanged.** The Governor in January and April proposed a number of reforms to state funding for child care, most notably:

- Converting current family income limits (about \$39,000 for a family of four) to the corresponding percentage of the federal poverty level (FPL) and henceforth using that percentage of FPL as the state's ceiling for child care eligibility. No families currently being served would lose service as a result of this proposal. No costs or savings are scored.
- Requiring parents who use state-funded child care for their 11 and 12 year olds to certify that their local (less costly) after school programs do not meet the family's child care needs. Shifting children to the less costly after school program would save about \$24 million annually.
- Limiting guaranteed child care services for former CalWORKS recipients to three years after leaving cash aid. In the interim, they could apply for a "regular" child care slot as soon as they have earned income. No costs or savings are scored.
- Establishing county-wide eligibility (waiting) lists for child care (\$7.9 million cost).
- Creating a tiered reimbursement rate structure for child care providers, under which license-exempt providers could earn only 55% of what licensed providers earn (60% if they complete basic health and safety training or other early childhood education within 180 days). This proposal would generate about \$140 million in state savings.
- Limiting state-funded child care payments to the same rates paid in the local area by families who pay with their own funds. This reform would generate over \$8 million in savings.

The May Revision includes a variety of mostly technical adjustments relative to child care, but does not revise any of the proposed reforms described above.

**Proposition 98 Reversion Account.** The May Revision proposes to increase expenditures from the Proposition 98 Reversion Account by about \$35.7 million from the January level, for the following programs:

- \$17.4 million (in addition to the \$20 million proposed in January) for Community College expansion of career technical education (voc ed) curriculum
- \$9 million for charter school facilities
- \$5.6 million for a voluntary pilot program (California Local Education Accountability Reform, or "CLEAR") to delegate budgetary and academic decision-making to the individual school site level
- \$2.2 million in one-time startup costs for the new California English Language Development Test (CELDT) contract
- \$1.5 million for a court-ordered payment to the Sunnyvale School District to settle desegregation claims covering a number of years in the mid-1980's through early 1990's.

## Higher Education

**Community College Funding Grows.** The Community Colleges' share of Proposition 98 rose from 10.35% in January to 10.46% at the May Revision (\$5.16 billion to \$5.22 billion).

Significant May Revision adjustments to the CCC's budget include:

- \$40 million for equalization
- \$31.4 million in Partnership for Excellence funding, restored as a result of the CCCs' agreement to provide accountability data sought by the Administration
- \$17.4 million increase (\$37.4 million total) for vocational education coursework articulation, pursuant to the Governor's Career Technical Initiative
- \$14.1 million to fund an increased statutory COLA, from 3.93% to 4.23%.
- \$10 million in one-time funding for equipment and infrastructure to allow districts to increase nursing program enrollment by 1,800 slots
- \$500,000 for the Cal-PASS data sharing system, contingent on matching fund contributions from UC and CSU

**Compact with University of California and California State University Continues.** The May Revision continues to adhere to the compact struck by the Governor with the UC and CSU in spring 2004, which called for base funding increases of 3 percent, enrollment growth of 2.5 percent, and student fee increases averaging no more than 10 percent annually.

- \$1 million (\$750,000 to UC and \$250,000 to CSU) is provided to launch a "Science and Math Teacher Initiative" that was mentioned in last year's compact but has until now remained unfunded
- No state funding is provided for outreach, nor for the UC Labor Institute

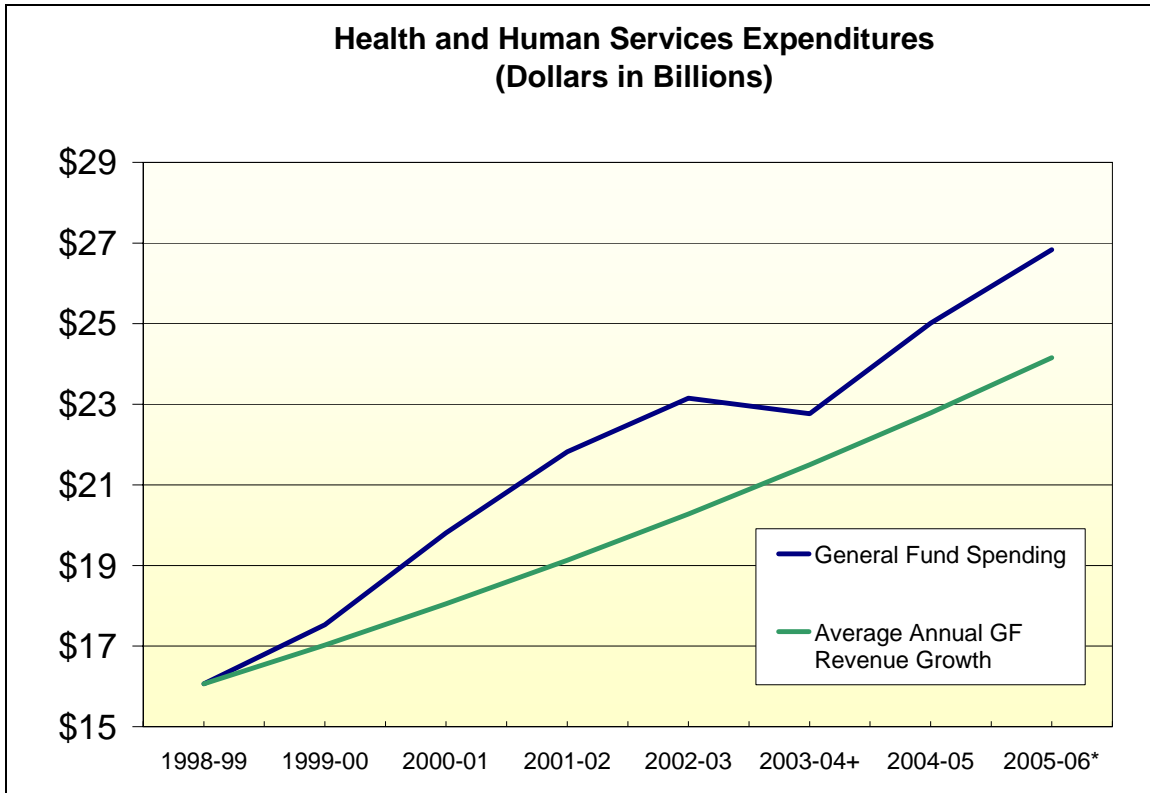
**Student Financial Aid Funding Grows.** The May Revision provides several augmentations to student financial aid funding:

- \$15.7 million to reflect an increased estimate in the number of 2005-06 Cal Grants
- \$7.6 million in federal funding for the Chafee Foster Youth Program, which provides financial aid awards to foster youth
- \$7.5 million to rescind the reduction proposed in January to the maximum Cal Grant award for students attending private institutions to \$7,449 per year. The maximum award will remain unchanged at \$8,322 per year.

In addition to these augmentations, \$16 million more in one-time student Loan Operating Fund (SLOF) reserves will be used in support of Cal Grant awards, increasing SLOF funding from \$35 million to \$51 million. Such use of SLOF reserves reduces General Fund expenditures by an identical amount.

# Health and Human Services Overview

Chart 1



+ The 2003-04 General Fund reflects one-time savings from accrual-to-cash accounting (\$1 billion) and enhanced federal fiscal relief (\$566.1 million) in the Medi-Cal program

\*As proposed in the May Revision

**Average annual General Fund expenditure growth from 1998-99 to 2004-05 of 8 percent**

**Average annual General Fund revenue growth from 1998-99 to 2004-05 of 6 percent**

The May Revision proposes expenditures of \$26.8 billion General Fund for all of Health and Human Services in 2005-06. This represents an increase of \$1.8 billion or 7.3 percent above the revised 2004-05 level, and accounts for over 30 percent of total General Fund expenditures. The spending increase of 7.3 percent exceeds the State's 2005-06 revenue growth rate of 4.9 percent. The Administration indicates that it is committed to maintaining access to health and human services programs while controlling costs; however, to the extent the May Revision proposes to increase spending at a rate that exceeds revenue growth, it does not appear that goal has been fully realized.

# Health

## Department of Health Services

**Increased Funding for California Rx (Cal Rx).** \$7.3 million General Fund in addition to the \$4 million proposed in the Jan. 10 Governor's Budget to implement the Cal Rx Program. It seems that the cost of this new state program is growing before it has even begun to be implemented. Access to affordable prescription drugs is an issue of national scope and importance. It may be prudent to let the federal government take the lead on developing remedies for this problem before calling upon California to create a potentially-costly new program and expanding the State bureaucracy.

## Medi-Cal

For 2005-06, the May Revision estimates Medi-Cal spending to be \$34.6 billion (\$13.0 billion General Fund), which represents an increase of \$514.9 million (\$16.1 million General Fund) above the Governor's January Budget proposal.

Currently, about one in six Californians qualify for Medi-Cal. The Medi-Cal caseload is expected to decrease by 74,900 beneficiaries relative to the Governor's January Budget (a decrease of 1.1 percent). A variety of Medi-Cal Program expansions that have added 1.2 million new recipients over the past five years has put tremendous fiscal pressure on this State. The General Fund cost of these expansions was \$158 million in the first year of implementation, but General Fund costs are expected to exceed \$1.2 billion in fiscal year 2005-06.

### Major Medi-Cal General Fund Adjustments include:

- **Medicare Part D "Clawback"** - A one-time reduction of \$135.6 million as a result of a federal decision to delay states payment of the "clawback" (February 2006 instead of January 2006).
- **Medicare Part D Excluded Drug Coverage** - An increase of \$46.8 million to provide coverage of "excluded drugs", which are drugs that are currently covered by Medi-Cal that will not be covered by Medicare Part D.
- **Medicare Part D Managed Care Savings** – A decrease of \$57.6 million to reflect savings associated with lower managed care capitation payments to Medi-Cal Managed Care plans since dual eligibles (i.e., persons eligible for both Medicare and Medi-Cal) will now receive drugs through Medicare.
- **Pharmacy Cost Controls** - A reduction of \$94.3 million in projected pharmacy expenditures due savings from the 2004-05 pharmacy cost control initiative and the withdrawal of Vioxx.
- **Nurse Facility Quality Assurance Fee (AB 1629) Delay** - An increase of \$144.6 million due to the delay in implementation of the nursing facility quality assurance fee and the associated rate increase (pursuant to Chapter 875, Statutes of 2004 [AB 1629]).
- **Long Term Care Rate Increase** - An increase of \$29.9 million to reflect a rate increase for long term care providers that that will not receive one under the Nursing Home Quality Assurance Fee (AB 1629) proposal.

- **CalOPTIMA Rate Increase** - An increase of \$9.2 million to provide a three percent rate increase for CalOPTIMA (Orange County's County Organized Health System). The health plan has depleted its financial reserves, which is at least partially a result of the Medi-Cal Managed Care rate freeze and the fact that CalOPTIMA had not had a rate increase in the two years preceding the rate freeze.

**Medi-Cal Program Redesign.** The May Revision continues the Governor's major changes to the structure of the Medi-Cal program that are intended to increase efficiencies, improve health care, and better control program costs. However, Democrats in the Legislature have already rejected or modified several key components in Budget Subcommittee (e.g., Limits on Adult Dental Benefits, Beneficiary Cost Sharing, Monitoring County Performance Standards, and a Pilot Project for Privatization of the Eligibility Determination function), resulting in a significant reduction to the long-term savings assumed by the Administration. The Administration should make sure that **all** of the components of this long awaited reform are part of the final 2005-06 Budget.

## **Public Health**

**West Nile Virus (WNV).** The May Revision provides \$12 million General Fund, on a one-time basis, to enhance and expand mosquito control efforts across the state. Of these funds, \$10 million will be in the form of local assistance to supplement the resources of existing mosquito control programs and expand mosquito control programs to cover currently unserved areas of the state. Funding will support mosquito control and abatement activities in WNV high risk areas and provide for emergency mosquito control in WNV hot spots.

**Revised Proposition 99 Expenditure Proposal.** The May Revision projects \$321 million in Proposition 99 (Cigarette and Tobacco Surtax Fund) revenues, which is an increase of 3.9 percent above the Governor's January Budget. The May Revision generates one-time Proposition 99 fund savings by utilizing a \$20 million balance in the Major Risk Medical Insurance Fund (MRMIF). In addition, Proposition 99 revenues have increased by \$12 million in the budget year due to a reduction in tax evasion for other tobacco products.

The May Revision includes a new proposal for Proposition 99 expenditures that will alter expenditures and transfers for programs within the Managed Risk Medical Insurance Board, the Department of Mental Health, and Department of Health Services, as follows:

- Fund the Access for Infants and Mothers (AIM) program with Proposition 99, and use Proposition 99 funds to match the State Children's Health Insurance Program (SCHIP) federal match in 2004-05 and 2005-06 via a federal State Plan Amendment that allows these funds to be used to provide prenatal care to unborn children.
- Fund AIM and Every Woman Counts (i.e., Breast and Cervical Cancer Early Detection Program) caseload increases using Proposition 99 funds in 2004-05 and 2005-06.
- Fund the Medi-Cal New Qualified Aliens Program and the Department of Mental Health state hospital caseload using General Fund, instead of Proposition 99 funds, in both 2004-05 and 2005-06.
- Provide Proposition 99 funding to support state costs resulting from the Orthopedic Hospital legal settlement in 2004-05 and 2005-06.

- Fund increased expenditures for the California Healthcare for Indigents Program and the Rural Health Services program on a **one-time** basis.
- Provide a **one-time** increase to support expanded tobacco control and smoking prevention activities.
- Provide a **one-time** increase to support surveillance, community and school-based case management, and quality assurance efforts to better manage asthma in order to avoid unnecessary hospitalization and missed school and work days resulting from this disease.

The table below reflects the fiscal impact of these changes:

**Table 4**

<b>FY 2004-05 (Dollars in thousands)</b>						
	<b>Health Education Account (0231)</b>	<b>Hospital Account (0232)</b>	<b>Physicians Account (0233)</b>	<b>Unallocated (0236)</b>	<b>Total Impact to Prop 99 Funds</b>	<b>Impact to General Fund</b>
AIM-GF to P99 Match		\$18,228	\$6,746		\$24,974	-\$24,974
AIM-MR Caseload Adj.		\$1,110		\$0	\$1,110	
Every Woman Counts Caseload				\$2,400	\$2,400	
Newly Qualified Aliens		-\$4,645	-\$6,746	-\$42,963	-\$54,354	\$54,354
Remove DMH		-\$16,724	\$0	\$0	-\$16,724	\$16,724
Orthopedic Hospitals		\$3,631		\$42,473	\$46,104	-\$46,104
<b>Totals</b>	<b>\$0</b>	<b>\$1,600</b>	<b>\$0</b>	<b>\$1,910</b>	<b>\$3,510</b>	<b>\$0</b>
<b>FY 2005-06</b>						
AIM-GF to P99 Match		\$20,269	\$7,185	\$0	\$27,454	-\$27,454
Every Woman Counts Caseload				\$1,139	\$1,139	
AIM-MR Caseload		\$3,334	\$0	\$0	\$3,334	
Orthopedic Hospitals		\$5,823	\$0	\$20,008	\$25,831	-\$25,831
Newly Qualified Aliens		-\$5,206	-\$7,185	-\$20,402	-\$32,793	\$32,793
Remove DMH		-\$20,491	\$0	\$0	-\$20,491	\$20,491
Competitive Grants	\$3,000			\$1,000	\$4,000	
Asthma				\$4,000	\$4,000	
CHIP		\$12,332	\$10,652		\$22,984	
RHS		\$1,371	\$1,183		\$2,554	
Healthy Families CA				\$175	\$175	
<b>Totals</b>	<b>\$3,000</b>	<b>\$17,432</b>	<b>\$11,835</b>	<b>\$5,920</b>	<b>\$38,187</b>	<b>-\$1</b>

The May Revision also ***proposes policy legislation to amend Proposition 99*** to authorize the use of Proposition 99 funding to draw down federal financial participation. This legislation will allow California to maximize federal funding for health services programs. Similar to Proposition 99 amendments enacted by the Legislature in previous years, this legislation requires approval by a 4/5 vote.

## **Managed Risk Medical Insurance Board**

### **Healthy Families Program**

**Caseload.** Expenditures for the Healthy Families Program (HFP) are projected to be \$959.3 million (\$347.4 million General Fund), which is an increase of \$64.4 million (\$22.2 million General Fund) above the Governor's January Budget. The Administration estimates that enrollment will grow from 740,835 by year-end 2004-05 to 867,418 in 2005-06 for a total increase of 126,583 children. This new caseload estimate is highly optimistic; however, caseload has increased significantly in recent months (it reached 712,557 as of February 2005).

**Rate Increase.** The May Revision includes \$5.1 million to provide a 2.9 percent rate increase to HFP health plans. The HFP had a rate freeze in place for the past two years pursuant to the 2003 Omnibus Health Budget Trailer Bill (AB 1762).

## **Department of Developmental Services**

**Regional Centers.** The May Revision proposes \$2.9 billion (\$1.9 billion General Fund) to support the Regional Centers in fiscal year 2005-06. This reflects a decrease of \$30.1 million (a decrease of \$78.1 million General Fund and an increase of \$47.3 Reimbursements and \$700,000 Federal Funds) over the Governor's Budget estimates. These adjustments are primarily attributable to the following:

- **Compliance with HCBS Waiver** - An additional \$9.7 million (on top of a \$10.5 million augmentation in the January Budget) to help Regional Centers maintain compliance with caseload ratios for the federal Home and Community Based Services (HCBS) Waiver.
- **Purchase of Services** – A net reduction of \$47.8 million related to changes in the Base, Updated Population and Utilization Data, and reduced Placement/Deflection costs.

**Developmental Centers.** The May Revision includes a net increase of \$9.4 million (\$6.1 million General Fund) compared to the Governor's January Budget. In addition, a net reduction of 33.5 positions, which is generally attributable to a decline in the developmental center population of 55 consumers in 2005-06 (from 3,071 to 3,016). Additionally, the Administration is moving forward with plans to close a developmental center, which will actually result in higher costs:

- **Increased Costs for Agnews Closure** – The Governor's January Budget included ***a net increase*** of \$27.1 million General Fund as a result of the closure plan, which will transition residents to safe, stable, and extraordinarily expensive homes in the community (the ***payment rate per client could exceed those of similar community facilities by up to 300 percent***). The May Revision provides an ***additional*** \$6.7 million to restore 43.0

positions at Agnews Developmental Center during the transition period and delay the start date for Agnews State Employees in the community sooner.

## Department of Mental Health

**Repeal AB 3632 Mandate (Services to Handicapped and SED Pupils).** The May Revision provides \$90 million General Fund to reimburse counties for a portion of prior years costs (2002-03 thru 2004-05) claimed for the Services to Handicapped Students and Seriously Emotionally Disturbed (SED) Pupils under the “AB 3632” state-mandated local programs. In addition, an augmentation of \$468,000 is proposed in a separate Budget Item for the State Controller for a multi-year effort to audit county claims for these mandates.

The Department of Education May Revision letter includes Budget Trailer Bill Language to repeal these mandates, which were proposed for suspension in the Governor’s January Budget.

**Chronic Homelessness Initiative.** The May Revision includes a proposal that utilizes \$2.4 million of Proposition 63 (Mental Health Services Act) funds for collaboration between the Health and Human Services Agency, and the Business, Transportation and Housing Agency. These funds are available for two years and will be used *primarily for rent subsidies*. In addition, the May Revision redirects \$40 million from existing housing bonds and \$10 million from the California Housing Finance Agency to create 400-500 units of permanent housing with services for the mentally ill.

**Rescinds Precommitment SVPs to Remain in Local Custody.** The May Revision includes an increase of \$9.2 million General Fund to reflect the rescission of the Jan. 10 Budget proposal that would have required 100 precommitted Sexually Violent Predators (SVPs) to remain in local custody until the courts commit them as SVPs.

## Human Services

### Department of Social Services

**CalWORKs.** The May Revision provides \$6.8 billion total funds (1.5 percent increase over the Governor’s January Budget) for California Work Opportunity and Responsibility to Kids (CalWORKs) programs. Caseload is expected to be 483,500 in 2005-06, which is 10,500 recipients or 2.2 percent above the January Budget.

- **Restorations.** The May Revision restores \$79.5 million General Fund for maintaining the state’s earned income disregard level and \$12 million General Fund for lack of expanded welfare-to-work reforms. The state is still waiting for information from a statewide sanctions report that could provide additional information on incentives for individuals to work. Additionally, the May Revision proposes to set aside \$30 million in additional TANF funds (savings of \$22 million General Fund are still included in the budget) to provide incentives for counties to develop and implement work-oriented strategies as part of the Pay-for-Performance initiative. The Administration’s proposal does not include the previously proposed 5 percent withhold of counties’ single allocation funding for administration and employment services.

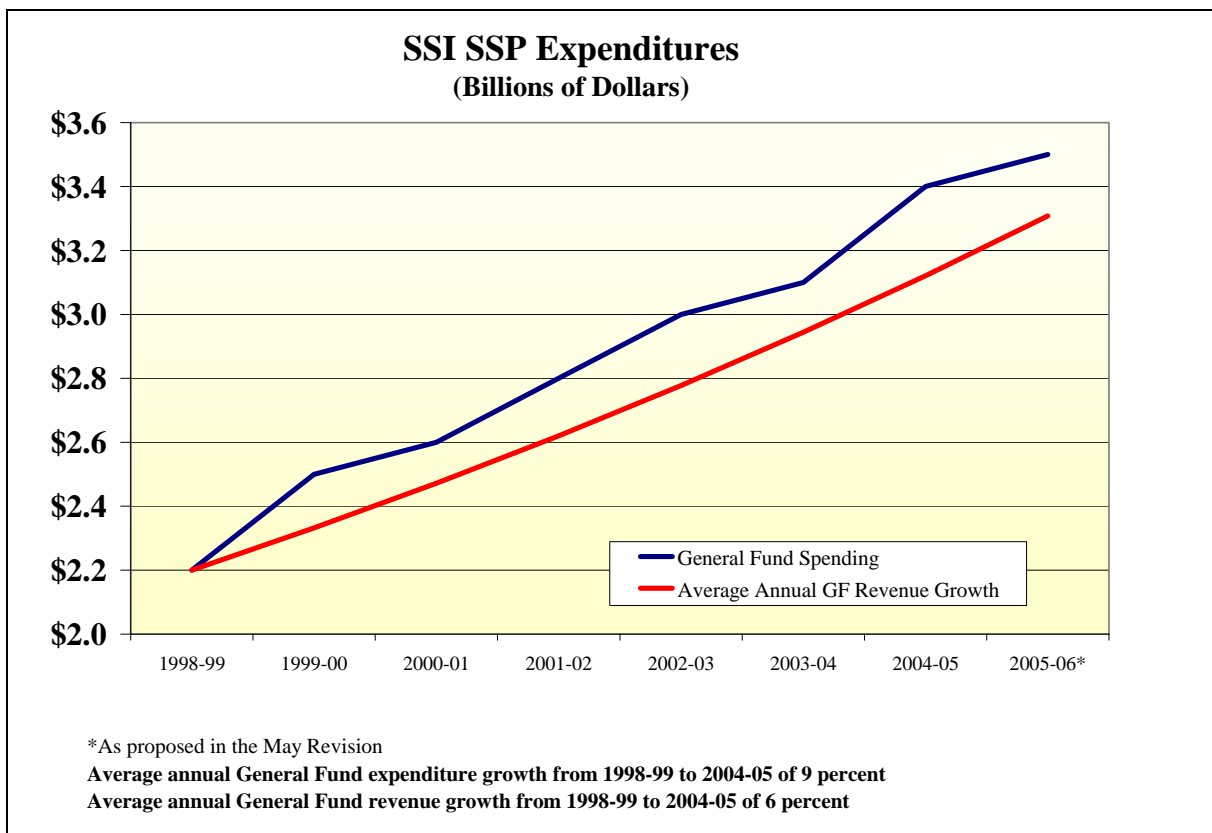


- **Savings Erosion.** The May Revision includes reduced savings attributable to CalWORKs grant reductions due to delaying implementation from July 1, 2005 to October 1, 2005, for a General Fund increase of \$52.7 million in 2005-06.

**Supplemental Security Income/State Supplementary Payment (SSI/SSP).** The May Revision proposes \$3.5 billion General Fund for SSI/SSP in 2005-06, a decrease of \$45.4 million General Fund below the Governor's January Budget. The May Revision estimates caseload of 1,214,200 in 2005-06, a decrease of .2 percent from the January Budget.

- **Lower Caseload and Grant Costs.** The May Revision includes a decrease of \$35 million due to lower caseload and average monthly grant expenditures in the SSI/SSP program. The Administration continues to assume suspension of the January 2006 state COLA and non pass-through of the federal COLA. The May Revision assumes additional savings of \$12 million General Fund for the January 2006 SSI/SSP federal cost-of-living adjustment due to a higher federal cost-of-living adjustment factor. It is important to note, however, that SSI/SSP grants will include a 2.7 percent federal COLA and a 2.75 percent state COLA that went into effect April 1, 2005.
- **Cash Assistance Program for Immigrants.** The May Revision includes increased expenditures of \$1.6 million General Fund to reflect costs associated with the delayed implementation of the Cash Assistance Program for Immigrants (CAPI), which is designed to shift individuals that currently receive state-only CAPI benefits to the federal SSI program.

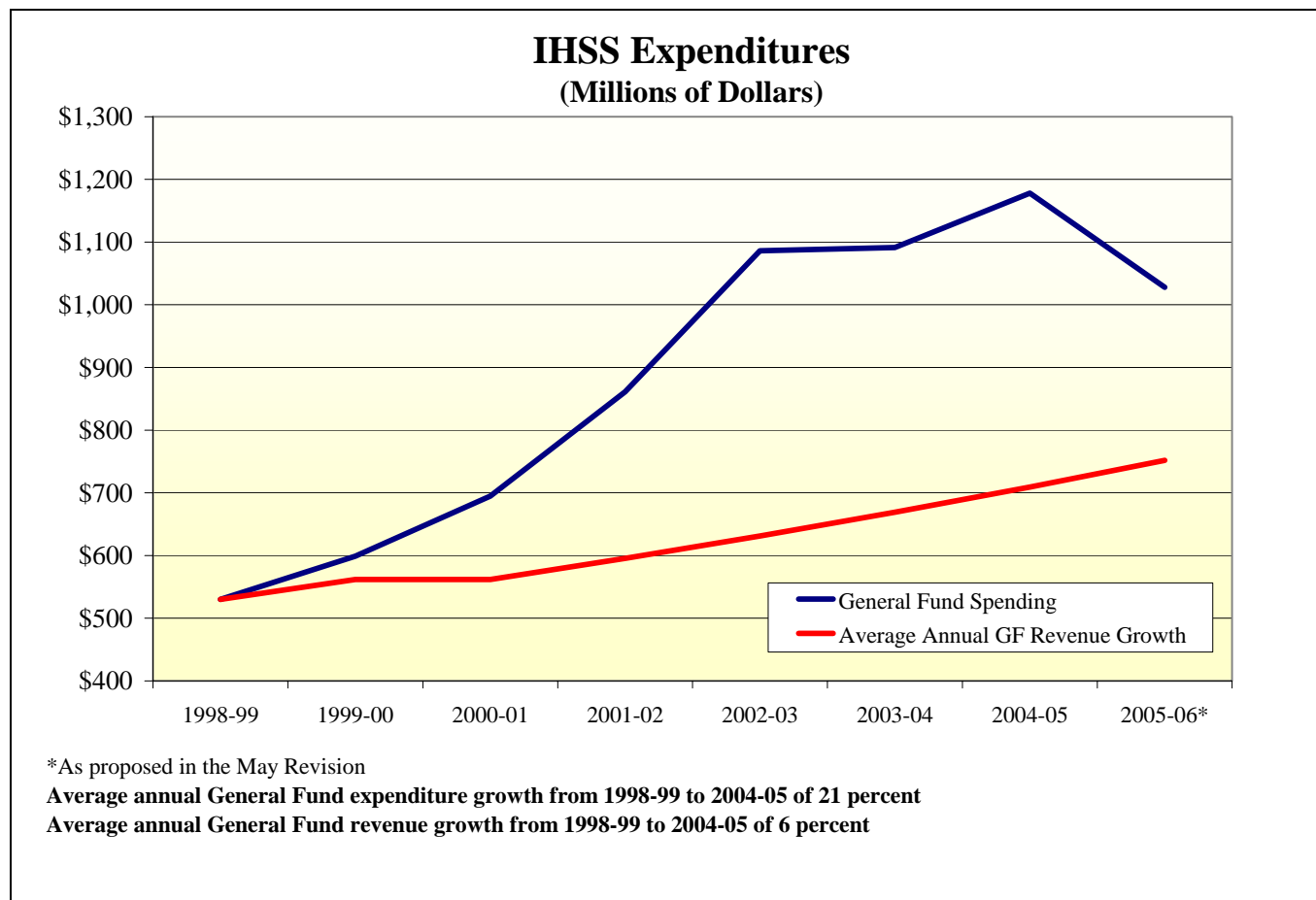
**Chart 2**



**In-Home Supportive Services (IHSS).** The May Revision proposes an increase of \$4.4 million General Fund for the IHSS program in 2005-06 above the Governor's January Budget. The caseload is estimated to be 375,000 recipients in 2005-06, a decrease of 7,000 recipients from the Governor's January Budget.

- **Medi-Cal Share-of-Cost Rules.** The May Revision includes an increase of \$10.6 million General Fund to continue funding costs associated with applying Medi-Cal share-of-cost rules to certain IHSS recipients. The Administration is holding recipients harmless for any additional share-of-cost they may have incurred under last year's federal waiver.
- **Lower Caseload.** Lower IHSS caseload results in reduced expenditures of \$6.5 million General Fund in 2005-06.

**Chart 3**



**Child Welfare Services (CWS).** The May Revision includes expenditures of \$629.5 million in 2005-06, a decrease of \$15.6 million compared to the Governor's January Budget. The reduced level of funding is mainly attributable to lower caseload projections and the transfer of additional federal TANF Block Grant funding to the federal Social Securities Block Grant (Title XX) for eligible Family Reunification and Permanent Placement activities.

- **Revised Program Improvement Plan.** The Governor's January Budget included \$11.5 million General Fund to expand systematic program changes designed to improve program performance to an additional 11 counties in 2005-06 (11 counties are currently

implementing these changes in 2004-05). The May Revision pulls back on the expansion, delaying implementation of improvement activities to the second set of counties pending an evaluation of the initial 11 counties. The 2005-06 Budget would redirect \$8.8 million General Fund originally proposed for expansion activities to support efforts identified by the original pilot counties.

## Department of Child Support Services

The May Revision assumes deferral of the 2005-06 penalty payment (\$223 million General Fund) until September 30, 2006. The Administration indicates this should be the state's final penalty payment as the department will seek certification of the single statewide automated child support system within the 2006-07 federal fiscal year (FFY). If the state is certified within the 2006-07 FFY, the state could be reimbursed up to 90 percent of the penalty amount. The budget continues to assume the 2004-05 federal penalty (\$218 million General Fund) will be paid in 2005-06.

## Transportation

**Proposition 42 fully funded.** Enacted by the voters in the March 2002 election, Proposition 42 amended the State Constitution to permanently dedicate sales taxes on gasoline for transportation projects. Specifically, the Proposition requires the transfer of gasoline sales tax revenues from the General Fund to a newly created Transportation Investment Fund (TIF). The Proposition also allows the Administration and the Legislature (if two-thirds of the membership approve) to suspend the transfer of sales tax revenues in a fiscal year in which the transfer will result in a significant negative impact on government functions funded by the General Fund.

Proposition 42 transfers have been suspended for the last two years. In fiscal year 2003-04, \$868 million of the \$1.157 billion in gasoline sales tax revenues was suspended. For 2004-05, the entire \$1.243 billion is suspended. However, the May Revision proposes to fully fund Proposition 42 at \$1.313 billion in 2005-06, and allocate the funds pursuant to existing law as follows:

- \$678 million to the Traffic Congestion Relief Fund
- \$127 million to the Public Transportation Account
- \$254 million to the State Transportation Investment Program
- \$254 million to cities and counties for local streets and roads

The table below displays the funding and suspension history of Proposition 42 since implementation in 2003-04.

Table 5

Proposition 42 Funds		
(Dollars in millions)		
<u>Fiscal year</u>	<u>Amount to be Transferred</u>	<u>Amount Suspended</u>
2003-04	\$1,157	\$868
2004-05	1,243	1,243
2005-06	1,313	0
<b>Total</b>	<b>\$3,713</b>	<b>\$2,111</b>
<b>57% of Prop. 42 Funds Have Been Suspended</b>		

In total, \$2.1 billion or approximately 57 percent of voter-approved Proposition 42 transportation funds have been retained in the General Fund and used for non-transportation purposes.

The May Revise also continues various proposals regarding future suspensions and repayment of Proposition 42 transfers, as follows:

- Legislation is proposed to repeal the authority for suspending Proposition 42 transfers, beginning in fiscal year 2007-08. Republicans have argued that taxes imposed on gasoline sales ought to be dedicated to transportation projects to alleviate traffic congestion and repair streets and roads. This proposal would help ensure that voter-approved transportation funds are used only for transportation purposes.
- Proposition 42 suspensions that are not repaid by July 1, 2007, are to be repaid within 15 years. The amount of the repayment in any fiscal year is to be at least 1/15<sup>th</sup> of the total amount owed.
- The proposal also authorizes the issuance of bonds to be used for purposes consistent with Proposition 42. These bonds would be secured by repayments of Proposition 42 funds.

While full funding of Proposition 42 is commendable, it should be noted that Proposition 42 funds could still be diverted next year; and the proposed 15-year repayment term on \$2.1 billion would add less than 3 percent, or \$141 million a year, to Caltran's total annual operating budget.

**Repayment of transportation loans from tribal gaming bonds delayed.** Between fiscal years 2001-02 and 2004-05, the General Fund borrowed a total of \$3.667 billion from transportation, including \$1.556 billion in loans from various transportation accounts, and \$2.111 billion from the 2003-04 and 2004-05 Proposition 42 suspensions.

For 2004-05, a total of \$1.397 billion was proposed to be repaid from a variety of funding sources, authorized by both the 2004 Budget Act and AB 687 related to tribal gaming compacts. Specifically, the Budget Act authorizes repayment of \$183 million from a combination of General Fund and Public Transportation Account "spill-over" revenues. Also,

AB 687 (Chapter 91, Statutes of 2004) proposes to repay \$1.214 billion from bond proceeds secured by tribal gaming revenues.

At the time of this analysis, the timing for sale of the bonds is uncertain due to litigation that has been filed against the State. The 2005-06 budget included trailer legislation that would make repayment of these transportation loans contingent upon receipt of tribal gaming bonds. The May Revision proposes to decrease the repayment from these bonds by \$222 million due to the absence of new compacts. This amount will either be repaid from additional compact negotiations or as part of the 15-year transportation repayments discussed above.

**Public Transportation Account (PTA) “spill-over” funds.** Current law contains an arcane formula that requires the General Fund to transfer sales tax revenues to the PTA under specified conditions. This transfer is often triggered during periods of high gasoline prices and is used to fund rail and mass transit projects. The May Revision transfers \$380 million in “spill-over” funds to the General Fund. This proposal would, in effect, divert monies from public transit projects to the General Fund.

**Redirection of funding from administration to construction.** The May Revision proposes to reduce Caltrans’ administrative budget by \$50 million in the current year and carry over these savings into the budget year, to be used for capital outlay programs. The savings in the current year is primarily attributable to excess salary savings from vacant positions. At the same time, Caltrans is proposing to increase the capital outlay support program by 175 positions and contracts totaling \$79.9 million.

**Legislation to Improve Transportation Management and Project Delivery.** The Administration has proposed 3 pieces of legislation for the 2005-06 Legislative Session, known collectively as “GoCalifornia”, which are intended to reduce congestion and expedite project delivery. The specific proposals are as follows:

- AB 850 – increases opportunities for public-private partnerships in the construction of High Occupancy Toll (HOT) lanes, whereby a single passenger may assess a diamond lane if they pay a specified toll.
- AB 1266 – increases use of design-sequencing on transportation projects, allowing construction to begin prior to full completion of the design phase.
- AB 705 – increases use of design-build so that one contractor would be responsible for both the design and construction of the project.

## **Local Government**

**Partial Vehicle License Fee Gap Loan Repayment.** The May Revision proposes to repay cities and counties for \$593.4 million (about half) of the vehicle license fees (VLF) that they did not receive in 2003-04 due to the suspension of the VLF offset. Payment of the VLF gap loan is not required until 2006-07, but prepaying a portion of it in 2005-06 will relieve state budget pressure in 2006-07 and provide much-needed revenues to local governments earlier.

**Property Tax Administration Grant Program.** The May Revision proposes an increase of \$2.5 million to partially restore a \$5.7 million January reduction for property tax administration.

The Administration now proposes the elimination of grant funding for (1) basic aid counties (Marin and San Mateo) that do not generate property tax revenues that offset the state's Proposition 98 obligation and (2) counties that have never submitted an application for grant funding (Alpine, Inyo, Mariposa, Sierra, and Trinity). The May Revision assumes revised funding for the program of \$56.8 million.

**Payments to Counties for Costs of Homicide Trials.** The May Revision proposes budget bill language that would enable Stanislaus County to receive reimbursement for the costs of the Scott Peterson homicide trial.

**Peace Officer Procedural Bill of Rights Mandate.** The May Revision includes \$18.1 million General Fund to provide funding for the Peace Officer Procedural Bill of Rights Mandate. This mandate has been deferred since 2001-02.

## **Resources, Environment and Energy**

For 2005-06, General Fund expenditures for resources and environmental protection programs increased by approximately \$288 million over the revised 2004-05 budget. This increase is primarily attributable to the costs for improving fire suppression efforts, settling the Paterno lawsuit, and paying for employee compensation and debt service costs. These and other select topics are discussed below.

**Department of Forestry and Fire Protection (CDF).** The CDF's primary duties include oversight of the State's forests and fire suppression on the State's forestlands and State responsibility areas, also known as SRA's. For the 2005-06 fiscal year, the budget proposes funding for fire suppression activities as follows:

- \$25 million for emergency firefighting costs;
- \$10.8 million for the replacement of 40 fire engines and other fire-fighting equipment; and
- \$9 million for firefighters to provide year-round fire suppression coverage in the counties of Riverside, San Bernardino, and San Diego.

The May Revision proposes an additional \$5 million for purchase of fire engines. At an average cost of \$270,000 per engine, this would add 19 engines to CDF's fire-fighting fleet.

**Paterno settlement.** A California Court of Appeals recently found the State financially responsible for a 1986 levee break in Yuba County that flooded 7,000 acres of land. Initially, the Governor's budget proposed to fund the settlement amount of \$464 million with a settlement bond. However, due to legal barriers, the May Revision proposes to fund this amount through an agreement with Merrill-Lynch, wherein the plaintiffs would be paid \$464 million in a lump sum and the State would pay Merrill-Lynch the principal plus variable interest based on the London Interbank Offering Rate (LIBOR). The current rate is approximately 4.29 percent.

**CALFED financing proposal.** CALFED is a consortium of State and federal agencies created to address various inter-related water problems in the Bay-Delta region over the next 30 years. CALFED goals include improving water quality and wildlife habitat, increasing water supply,

and reducing flood risks from levees. However, since CALFED began implementing programs and project construction in 2000, federal funding commitments have fallen short. During last year's budget subcommittee hearings, the Senate adopted a proposal that required the Bay-Delta Authority to adopt regulations establishing a CALFED user fee effective in the 2005-06 fiscal year. Upon strong urging from Republicans, the Governor agreed to withdraw all language related to a CALFED fee.

In January 2005, the Governor's budget included a framework for financing CALFED over the next 10 years that would reduce the State's contribution by assuming increased federal funds and increasing fees on local water agencies and other water users. However, due to stakeholder opposition, the May Revision CALFED finance plan has been modified from a 10 year \$8.1 billion plan, to a 2-year interim \$1.6 billion plan to allow the Administration time to work with water user groups on funding options. The proposal also includes "reimbursements" (a.k.a. fees) of up to \$30 million annually for the Ecosystem Restoration Program, and \$300,000 for an independent review and evaluation of CALFED. Also, there is no mention of a statewide water tax.

While the May Revision is a step in the right direction, the following concerns are noted:

- The revised plan represents a deferral, not a reduction, from the initial \$8.1 billion CALFED plan. Water users support a scaled-back plan (\$4.8 billion) that would mitigate the need for taxes and fees.
- Increases fees in the Ecosystem Restoration Program, *prior* to completion of the independent evaluation of how past funding has been spent or whether benefits were derived that are consistent with water user contributions.
- Does not provide additional assurances to protect water users from future water loss or financial outlays for projects such as habitat restoration.
- Assumes an improbable increase in the federal contribution amount of \$40 million, but does not propose a plan for how to deal with this shortfall should federal funds not materialize.

## **Statewide Issues**

**Augmentation for Employee Compensation.** The May Revision includes funding for salary increases required under current contractual obligations for a number of bargaining units, including highway patrol, correctional peace officers, firefighters, engineers, crafts and maintenance, and psychiatric technicians. Overall, the May Revision includes a General Fund decrease of \$36.1 million due to reduced General Fund contributions for Bargaining Unit 6 as a result of the unit's contractual ties to Bargaining Unit 5.

**Health and Dental Benefits for Annuitants.** The May Revision restores \$34.5 million General Fund for unachievable savings previously assumed for the Medicare Modernization Act in 2005-06. The Administration indicates savings will be achieved in subsequent years as reimbursements from the federal government could be received as early as September 2006.

**Section 3.60 CalPERS Rate Adjustments.** The May Revision includes savings of \$152.7 million General Fund resulting from the adoption of a new policy for calculating the actuarial value of assets. The new policy includes spreading the market value asset gains and losses

over 15 years as opposed to the current 3 years, and changing the corridor limits for the actuarial value of assets from 90 percent—110 percent of market value to 80 percent—120 percent of market value. This change does not reflect any differences that would be caused by the Governor's policy proposals in this area.

**Restructuring the State's Pension System.** The Governor has pulled back his support and is no longer seeking a constitutional amendment to prohibit the state and any of its political subdivisions from offering defined benefit retirement programs to new employees. However, the Administration continues to support minor reform through the budget process and, as such, the May Revision continues to assume savings of \$877 million General Fund for the pension reform and employee compensation proposals that were included in the Governor's January Budget.

**Pension Obligation Bond.** The May Revision continues to assume sale of the Pension Obligation Bond (POB) in 2005-06, generating General Fund relief of \$525 million, a reduction of \$240 million from the January Budget which assumed \$765 million in General Fund relief from the POB.

**Senior Citizens Property Tax Assistance Programs.** The May Revision proposes to restore \$136.6 million in General Fund Support in order to fully fund the property tax assistance and renters' tax assistance programs.

**Strategic Sourcing.** The May Revision proposes to continue the Strategic Sourcing procurement initiative for purchasing goods and services, but the Administration proposes to eliminate the assumed target savings of \$48 million in current year and \$96 million in budget year. Instead, the Administration proposes a control section to the budget which will allow the Department of Finance to reduce department appropriations when savings data can be verified.

**Boards and Commissions.** The May Revision proposes to eliminate 13 boards and commissions in an effort to streamline state government. Table 6 provides a list of the entities proposed for abolishment.



Table 6

BOARDS AND COMMISSIONS PROPOSED FOR ELIMINATION
<ul style="list-style-type: none"><li>➤ Advisory Committee on Managed Health Care</li><li>➤ Agricultural Bargaining Association Advisory Board</li><li>➤ Child Development Policy and Advisory Committee</li><li>➤ Clinical Advisory Council</li><li>➤ Commission of the Californias (Office of California-Mexico Affairs)</li><li>➤ Credit Union Advisory Committee</li><li>➤ Departmental Transportation Advisory Committee</li><li>➤ Heritage Preservation Commission</li><li>➤ Interagency Aquatic Invasive Species Council</li><li>➤ Mexican-American Memorial Beautification and Enhancement Commission</li><li>➤ Mortgage Bankers Advisory Committee</li><li>➤ Real Estate Advisory Commission</li><li>➤ Small Business Reform Task Force</li></ul>

## Public Safety and Judiciary

**Judicial Branch (State Trial Court Funding).** The May Revision proposes a baseline increase of \$24.3 million as a result of the statutory growth factor that ties operational increases to the State Appropriation Limit (SAL) for which the estimate has grown from 4.8 percent to 6 percent since the release of the Governor's Budget. This is in addition to the \$97.4 million SAL adjustment included in the Governor's Budget for a total increase of \$121.8 million. Another adjustment may be required when the May Revision SAL calculation is available and final.

**Department of Justice.** The May Revision proposes \$6.7 million (\$2 million General Fund and \$4.7 million DNA Identification Fund) to address workload associated with the DNA Fingerprint, Unsolved Crime and Innocence Protection Act (Proposition 69).

**Youth and Adult Correctional Agency (YACA).** The May Revision proposes a \$3.1 million General Fund and 20.2 personnel years as a first step to look at solutions to juvenile corrections and implement major reform of the juvenile justice programs in the state. This funding could be used to establish juvenile justice task forces and prepare facility and program analysis in an effort to "take a long-term strategic approach to reinventing California's broken juvenile corrections system."

This proposal was submitted without any specific details. Therefore, we are hopeful details and justification of the proposal becomes available to allow consideration by the Legislature of the need, benefit, and merit of the proposal.

The May Revision establishes a budget display consistent with the Governor's Reorganization Plan #1 that merges the all the departments within YACA into the new Department of Corrections and Rehabilitation.

**Department of Corrections (CDC).** The May Revision proposes a net increase of \$19.7 million General Fund in the current year and \$191.4 million General Fund in the budget year. The budget year increase includes \$85.4 million General Fund and 962.5 positions above the Governor's Budget based on higher spring population estimates as well as a reversal of savings assumed for parole accountability programs (\$58.1 million).

The estimated current year institution Average Daily Population (ADP) is 163,025, an increase of 6, and a parole ADP of 113,600, an increase of 10,108 over the Governor's Budget. The estimated budget year institution ADP is 165,249, an increase of 2,494, and a parole ADP of 110,335, an increase of 13,733 over the Governor's Budget. The budget year increase is based upon an increase in new admissions from court and parole violators with new terms, offset by a reduction in parole violators returned to custody.

Three new mental health facilities that would house approximately 6,000 inmates with a total cost of \$1.4 billion was proposed in an April Finance Letter. Specifically, \$12 million is requested for preliminary plans for a mental health facility in Chino, and \$3.3 million for a study for a mental health facility in San Luis Obispo. CDC is currently developing a proposal for a third facility in Sacramento.

This major policy issue seems more suited as a Governor's Budget proposal. This would provide the Legislature and all stakeholders time to review and analyze the proposal, as well as consider alternatives.

Some of the May Revision General Fund adjustments include:

- Restoration of \$51.2 million of the \$95.3 million reduction of funding for inmate and parole programs proposed in the Governor's Budget. The balance of the reduction (\$44.1 million) will be taken from the various inmate and parole programs which have been scaled back as a result of a change in policy or implementation problems.
- \$17.3 million and 59.6 positions to implement improvements in the dental program in order to avert a class action lawsuit.
- \$15 million, and 30 million ongoing funding in 2006-07, will be set-aside and available to CDC to enhance inmate and parole programs that have been determined to be effective and evidence-based. This funding will only be available pending a report to the Legislature.
- \$5.8 million and 46 positions to address personnel and physical plant security and safety issues at California Institution for Men in Chino. This is in response to the officer stabbing death that occurred at the institution. This is consistent with audit findings from the Board of Corrections and the Office of the Inspector General.
- \$5.2 million and 59.6 personnel years in order to comply with a court order issued under the *Coleman* lawsuit. These funds will be used to implement the revised guidelines for the

mental health service delivery system in the Administrative Segregation Unit and Security Housing Unit at the California State Prison-Corcoran and to fund recruitment and retention pay differentials for mental health positions at 12 institutions.

- \$10.6 million reduction to the *Plata* settlement proposal due to updated information that resulted in decreased staffing needs and contracting costs.
- \$2.4 million to construct an arsenic removal water treatment system at Kern Valley State Prison.
- \$1.4 million reduction related to estimated energy savings for energy efficiency projects.

**Department of the Youth Authority.** The May Revision proposes a current year net increase of \$18.8 million General Fund and a budget year net increase of \$13.5 million General Fund.

The Youth Authority population continues a downward trend and reflects an estimated 2005-06 year-end ward population of 2,615, a decrease of 715 wards than was projected in the Governor's Budget. The parole population is estimated to be 3,375, a decrease of 75 from the Governor's Budget.

Some of the May Revision General Fund adjustments include:

- \$10.1 million to reflect the need to adjust downward reimbursements to actual levels and backfill with General Fund.
- \$3.1 million and 11.4 personnel years to implement a disability remedial plan required by the *Farrell v. Allen* lawsuit.
- \$2.4 million and 19.1 personnel years to implement a sex offender treatment plan required by the *Farrell v. Allen* lawsuit.
- \$1.2 million and 14.7 personnel years to implement a mental health remedial plan required by the *Farrell v. Allen* lawsuit.

**Office of the Inspector General.** The May Revision proposes a workload adjustment of \$4.1 million General Fund and 24 positions as the result of developing a workload budget consistent with the legislative requirements of Chapter 733, Statutes of 2004 (SB 1342-Speier). An additional \$3.4 million General Fund and 19 positions are proposed to address the warden selection and institutional audit processes as required pursuant to Chapter 10, Statutes of 2005 (SB 737-Romero, et. al.).

**Board of Prison Terms.** The May Revision proposes \$2.1 million and 20.6 personnel years for increased parole revocation caseload.

**Board of Corrections.** The May Revision proposes to transfer authority for the distribution of \$201.4 million in federal Temporary Assistance for Needy Families funding for county youth probation programs from the Department of Social Services to the Board. The Board may use up to 0.5 percent of these funds for administration of the funds.

**Citizens' Option for Public Safety/Juvenile Justice Crime Prevention Act Allocation Realignment.** The Administration is withdrawing its proposal to de-link the Citizens' Option for Public Safety (COPS) and the Juvenile Justice Crime Prevention Act program (JJCPA)

legislation. COPS will still be funded at \$100 million and JJCPA will be provided \$26.1 million in order to adjust allocation timing to better match expenditures. JJCPA is fully funded for 2005-06 from the 2004 budget act appropriation. This will not result in any reduction to the JJCPA program.

**Small and Rural Sheriffs.** The May Revision restores \$18.5 million General Fund and fully funds this program which provides funding to 37 smaller county sheriffs' departments.

**Incarceration of Undocumented Felons.** The Budget assumes that the state will expend approximately \$79.4 million in federal State Criminal Alien Assistance Program funding for the 2005-06 fiscal year. These federal funds are for the partial reimbursement of the costs associated with the incarceration of the undocumented felon population in prison and are deposited into the General Fund.

## **General Government**

### **Departmental Issues**

**Office of Homeland Security.** The May Revision proposes legislation that would establish the Office as a separate independent entity as of January 1, 2006. Currently, the Office exists as a program within the Office of Emergency Services. This proposal includes an increase of federal fund authority of \$146.4 million for homeland security activities. Included in this increase is \$29.3 million for state operations and an additional 21 positions, for a total of 53 positions, to support the full-year workload needs of the Office. \$22 million of the state operations funding is provided to other state agencies such as the Department of the Military. The remaining \$117.1 million will be allocated to local agencies (grantees) for homeland security activities for fiscal year 2005-06.

While the concept of establishing a separate Homeland Security may have merit, it is a significant policy issue that might be better submitted as a Governor's Budget proposal so that the Legislature may have time to thoroughly review, analyze and consider the proposal.

**Office of Emergency Services.** The May Revision proposes \$35 million General Fund in budget year for the estimated costs of response and recovery efforts related to federally declared disasters in Southern California which were caused by flooding and mudslides due to winter storms. This increase will fund the state's share of the costs associated with these disasters. The increased costs of these disasters in 2004-05 (\$21.9 million) are funded through statutory authority.

The May Revision proposes an increase of \$5 million General Fund to purchase new fire engines for mutual aid support. At \$270,000 per fire truck, this would provide for 19. These engines will be housed at local fire departments and staffed by local personnel in order to improve the ability of state and local agencies to respond to wildfires, especially those in Wildland/Urban Interface areas. The May Revision also includes \$5 million for the Department of Forestry and Fire Protection to purchase fire trucks.

**Department of Veterans Affairs.** The May Revision proposes partial restoration of the unallocated reduction included in the Governor's Budget and includes \$876,000 General Fund. The unallocated reduction would be reduced to \$97,000.

**Office of Administrative Law.** The May Revision includes an increase of \$224,000 General Fund and 2.0 positions to determine whether particular state rules, guidelines, and other documents, are in fact regulations subject to the regulatory review process, and to enforce provisions of the current law that restrict state agencies from issuing, utilizing, or enforcing "underground regulations."

**Office of the State Inspector General.** The May Revision proposes \$2.3 million General Fund to establish the Office of the State Inspector General. This office will be staffed with 27 new positions to conduct audits and investigations into waste, inefficiencies, or possible illegal activity in all Administration-directed state departments other than those under the Department of Corrections and Rehabilitation. The Administration indicates that eventually 50 percent of the costs of this new office will be recovered through assessments on special and federal funds. Although this proposal may have merit, the Administration needs to make clear how this office's purview will differ from that of the Bureau of State Audits and the Department of Finance's auditing unit.

**Employment Development Department.** The May Revision includes an increase of \$10 million (\$5 million General Fund and \$5 million Employment Training Funds) for a new Nurse Education Initiative. These funds will support loan repayments, clinical simulators, and pre-apprenticeship programs. The Administration estimates the initiative will generate an additional 1,360 nurses a year.

**Department of Consumer Affairs.** The May Revision proposes to augment the Office of Privacy Protection by \$446,000 General Fund to increase identity theft education and outreach efforts to consumers, community-based organizations, the legal community, institutions of higher learning, and law enforcement agencies.

**Secretary for Business Transportation and Housing.** The May Revision proposes an increase of \$500,000 General Fund for the California Film Commission to upgrade the servers and software for state's film location database. The Administration also proposes language that allows funding to be spent after the Director of Finance approves a Feasibility Study Report (FSR) for the project. The Legislative Analysts Office recommends this funding request be denied, since it is standard practice for the Legislature only to approve a project with an approved FSR.

## Senate Republican Fiscal Staff Assignments

**Jeff Bell, Staff Director**  
(916) 651-1501

**Laurie Hall, Budget Committee Assistant**  
(916) 651-1501

<b><u>Assignment Area</u></b>	<b><u>Consultant</u></b>	<b><u>Phone</u></b>
Education	Cheryl Black	651-1501
Public Safety, Judiciary, Corrections	Doug Carlile	651-1501
Transportation, Energy & Environment	Therese Tran	651-1501
Health	Seren Taylor	651-1501
Human Services, Public Employees Retirement	Chantele Denny	651-1501
Revenue, State & Local Government, Taxes	Eric Swanson	651-1501

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